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Mumbai Masala, September 9, 2008

¶1. (U) Table of Contents:

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Currency Futures trading in India

¶2. (U) On 6th August, the Reserve Bank of India (RBI) unveiled the framework for trading of currency futures in India. These directives were finalized in consultation with the Securities and Exchange Board of India (SEBI) and various market participants. According to the final guidelines, currency futures can be traded in exchanges recognized by SEBI and will be governed by the instructions issued jointly by the RBI and SEBI. Only residents of India and banks authorized by the RBI (including foreign banks incorporated in India) are allowed to participate in the currency futures market (Foreign Institutional Investors are not, however). The market has trading limits which limit the size of individual positions, making it difficult for large players to participate. In order to facilitate market growth and liquidity the RBI is already considering lifting the limits. (Note: A currency futures contract is a standardized contract traded on an exchange which enables investors to hedge against foreign exchange risk. The holder of the contract agrees to buy or sell a certain underlying instrument -- in this case an exchange rate -- at a certain date in the future, at a specified price. End Note.) In India, currency trading, including forward contracts, is already allowed in the over-the-counter (OTC) market but exchange traded currency futures (ETCF) were not permitted.

¶3. (U) On August 29, the National Stock Exchange (NSE) became the first Indian exchange to launch ETCFs. To promote participation in this segment, NSE announced that it will not levy transaction charges on trades made from August 29 until the end of September. In a meeting prior to the launch, Ravi Narain, the Managing Director and Chief Executive Officer of the NSE, told Congenoffs that the transparent nature of currency futures market will ensure its popularity. However, he also pointed out that banks and companies would still likely use existing structured products for specific needs, despite their opaqueness. Both the Multi-Commodity Exchange (MCX) and the Bombay Stock Exchange (BSE) have sought approvals from SEBI to launch their own currency futures trading platform.

¶4. (U) Tarun Bhatia, Head-Financial Sector Ratings of Crisil Ratings, expressed his hope that the NSE would replicate its success with equity derivatives in the currency futures segment. He believes that the introduction of currency futures is a

"good step" as it adds dimension and diversity to the market. The market is prepared to take advantage of this new structured product, he added.

Are Banks Feeling the Pinch from the New Restrictions on Credit Cards?
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¶5. (U) On July 23, the Reserve Bank of India (RBI) issued a circular on the credit card operations of banks that tightened the existing norms that governed credit cards. In this circular, the RBI advised banks against charging excessive interest rates on cash advances, including credit cards, and suggested that each bank prescribe an interest rate cap. RBI also required banks to provide transparent explanations for the rejection of credit card applications. They also issued guidelines on other elements of credit card operations, such as obliging issuing banks to absorb losses from unsolicited credit cards, requiring customer permission to share credit information for marketing purposes, and to put in place a mechanism to ensure that customers acknowledge the receipt of the monthly statement.

¶6. (U) India has become one of the fastest-growing markets for credit card issuances, keeping pace with the general increase in consumer spending in India. However, rising credit card delinquencies have alarmed banks and credit card issuers. Uttam Nayak, the Country Manager for Visa in India, told Congenoff that the official delinquency rate is in the 6-7 percent range. However, he believes that local banks are underreporting their delinquency numbers and that the true number is about 15 percent. Sanjay Nayar, CEO of Citibank, also expressed concern about credit card delinquencies, telling Congenoffs that those

Citibank card delinquencies has risen to over 5 percent, from less than 2 percent a year ago. He blames this on the indiscriminate issuance of cards by banks in India as banks aggressively targeted existing cardholders of competitor banks for new card issuances.

¶7. (U) According to Rajiv Sabharwal, Senior General Manager, Retail Assets and Rural Finance Group at ICICI Bank, banks are required to report all loans, including credit card usage data, to Credit Information Bureau India Ltd (CIBIL), India's first credit information bureau. He also accepted that banks had been aggressively "selling cards," but this practice had lessened. He stated that last year, ICICI had accepted about 40 percent of the total applications received for credit cards, but he estimated this would slow to about 26 percent this year. Tarun Bhatia of Crisil, acknowledged that banks diligently reported credit data to the Credit Information Companies/CIBIL, but that the existing system did not keep a check on the overall individual credit limit. He added that banks were using their own existing database to lure customers to the banks' other segments/ products like insurance and home loans.

¶8. (U) Comment: This circular was based on a study undertaken by the RBI on the credit card operations of banks after the RBI and the Offices of the Banking Ombudsmen had received a number of complaints from credit card customers. This report also made a number of recommendations relating to the recovery of credit card debts through recovery agents. There have been a number of recent cases of recovery agents, hired by banks, using heavy-handed techniques to harass and intimate debtors. With the rise in the number of disputes and litigations against banks for engaging recovery agents, the RBI has issued specific guidelines that must be followed by the banks. With this move, the RBI has shown that it can be responsive to consumer protection issues, taking action to intervene in the fast-growing credit card market to protect credit card users from aggressive lending practices. End Comment.

The Real Estate Sector: New Entrants May Find Market Tough
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¶9. (U) On August 22, speakers at a seminar on "Changing trends in the Indo-US real estate sector" in Mumbai acknowledged that real estate asset prices had increased rapidly, driven by pent up demand for commercial and residential real estate in the country. Participants also highlighted the fact that such a rapid increase had attracted new developers, who had quickly over expanded and were struggling, at least in Mumbai's downturn.

¶10. (U) Niranjan Hiranandani, Managing Director at Hiranandani Group and one of the country's largest builders, explained that the real estate sector had grown from being a family-owned business into a corporate and professionally managed industry over the past few years. He stated that during the last 5 years, the sector had grown at a compounded annual rate of 35 percent, but is expected to slow to 15 percent this year. Sanjay Dutt, Joint Managing Director, Cushman & Wakefield, said that of the total real estate demand, almost 35 percent is from office space, 6 percent comes from the retail segment and the balance is from the residential sector. The key driver of demand for office space, accounting for almost 75 percent, comes from the IT-ITeS sector followed by banking and insurance, biotechnology, and research and development sector. The last few years also saw a shift in interest towards Tier-2 and Tier-3 cities. As land values became exorbitant and availability of land for developing large projects became an issue in Tier-1 cities, developers moved to the Tier-2 and Tier-3 cities. Also IT-ITeS companies were moving to other cities in search of cheaper real estate and manpower that augmented the demand in Tier-2 and Tier-3 cities. In the residential sector, the demand has increased along with rising disposable incomes and the trend towards nuclear family rather than joint family arrangement. Home buyers also sought out integrated townships that offered commercial, retail, residential, and leisure facilities in one given area.

¶11. (U) According to Nipun Sahni, Head of Global Commercial Real Estate at DSP Merrill Lynch, the real estate sector has attracted the greatest amount of investment through domestic capital markets. Out of the USD 22 billion raised through initial public offerings (IPO) last year, 42 per cent was by real estate firms. He predicted, however, that investments in infrastructure could surpass those in real estate as the former had a more diverse range of investment class. Dropping far more sharply in the recent downturn than the Indian capital markets as a whole, the market capitalization of the real estate sector

has dropped to $30 billion, from its peak of $90 billion in January 2008; the Bombay Stock Exchange Realty Index has lost more than 60 percent of its value from its peak. Currently all realty firms that had issued IPOs in 2007 are trading at discounts from their issue price, he noted. Jai Mavani, National Director of KPMG, explained that the valuations of recent real estate IPOs were based purely on "land banks" - the value of land owned by the developers - rather than future cash flows.

¶12. (U) Dutt continued that India's old and well established builders, often in the second or third generation of their business, understood the fundamentals of the real estate market. However, new players like Lanco, Satyam, Larsen and Toubro who entered the market to cash in on the booming real estate sector, were not able to capitalize on their investments due to lack of experience and declining economics of the sector. He hinted that as these players got impatient, they would look to sell out, leading to the survival of a few strong players. "Non-core players entered this business segment thinking that they would make a 40-50 percent return on investment (ROI) but given the current situation they do not see these returns materializing and hence they will look to exit", reiterated Pritam Chivukula, National Director at Colliers International. Mavani of KPMG acknowledged that currently capital was not circulating; there weren't any exit routes available for investors. Hence he felt the need for products like Real Estate Investment Trusts (REIT) and Real Estate Mutual Funds (REMF). These were not moving

forward, as the regulators perceived them to be a "back door entry" for Foreign Institutional Investors (FIIs). (Note: Press Note 7 released by the Government of India on the subject of Foreign Direct Investment (FDI) states that investment in construction development projects, including housing, commercial premises, resorts, educational institutions, recreational facilities, city and regional level infrastructure, townships is allowed up to 100 percent under the automatic route. However FDI is not allowed in the real estate business. SEBI released draft guidelines for REITs in December 2007, but has not yet given final approval for their launch. SEBI approved the launch of REMF in May 2008. End note.) He recognized the need for a sound interest rate and investment regime and a healthy mortgage market. Hiranandani agreed that RBI's anti inflation regime was keeping interest rates high and making mortgages more and more unaffordable. Sahni suggested that the regulator could apply differential interest rates for home borrowers and other borrowers or at least further relax the tax liability of a home borrower.
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